

## **BPA 7(b)(2) METHODOLOGY**

### **INVESTOR-OWNED UTILITY SUPPLEMENTAL RESPONSE**

**10/30/2007**

The supplemental response provided below addresses materials and comments presented by various parties at the October 22, 2007, Residential Exchange Workshop and supplements the “BPA 7(b)(2) Methodology – Investor Owned Utility Preliminary Response,” which was also submitted October 22, 2007.<sup>1</sup>

- 1. Should the portion of the output Mid-Columbia hydro resources sold to PNW investor-owned utilities be included in the 7(b)(2)(D) resource stack as available to the BPA to serve 7(b)(2) customer loads?**

#### **SUPPLEMENTAL RESPONSE:**

On October 22, 2007, in preliminary written responses to a request for feedback from BPA, the investor-owned utilities pointed out that the Mid-Columbia resources purchased by investor-owned utilities should be excluded from the 7(b)(2) resource stack. Mid-Columbia resources do not satisfy the statutory requirement that resources included in the 7(b)(2) resource stack must be “owned or purchased by the public bodies or cooperatives” (the “owned or purchased” requirement). Oral responses to BPA’s request for feedback, and to the investor-owned utilities’ written responses, included two comments that attempted to assert that these Mid-Columbia resources satisfy the “owned or purchased” requirement and could be included in the 7(b)(2) resource stack. Both arguments are inconsistent with the plain language of the statute and, therefore, are without merit.<sup>2</sup>

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<sup>1</sup> On October 29, 2007, public power submitted preliminary responses to BPA’s request for Feedback on 7(b)(2) and ASC methodology issues (“Public Power Comments”). The Public Power Comments were not distributed until the day before the investor-owned utilities’ supplemental response was to be submitted. As a result, the investor-owned utilities have not yet had an opportunity to fully respond to the Public Power Comments. The investor-owned utilities reserve the right to submit additional comments at a later time in response to the Public Power Comments. In that regard, silence regarding any argument or factual misstatement in the Public Power Comments does not indicate or imply agreement therewith or any undertaking to correct any or all such factual misstatements or respond to any and all such arguments.

<sup>2</sup> Also, the Public Power Comments erroneously argue at page 4 that pricing preference customer resources in the resource stack at market would render surplus the provision of section 7(b)(2) that addresses pricing of additional resources when all of the preference customer resources in the resource stack are exhausted.

First, one comment suggested that the Mid-Columbia resources satisfy the “owned or purchased” requirement because the preference agencies own the physical generating facilities—i.e., the dams that produce electric power. The investor-owned utilities do not dispute that the preference agencies own the dams. However, that fact is irrelevant. Section 7(b) states, in relevant part, “. . . and were the least expensive resources owned or purchased by public bodies or cooperatives[.]” (Emphasis added.) Section 3(19) of the NWPA defines “resource” as electric power; resources are not the physical generating facilities that produce electric power. As explained in the investor-owned utilities’ October 22 written responses, the investor-owned utilities have purchased the relevant electric power and, therefore, the investor-owned utilities own those Mid-Columbia resources. Accordingly, BPA should forecast that the resources represented by the power from the Mid-Columbia projects that are purchased by the investor-owned utilities will not be owned or purchased by the preference agencies. As a result, those resources cannot be included in the 7(b)(2) resource stack.

Second, a comment was made that the investor-owned utilities’ position (that the resources (electric power) are not “owned or purchased by” a preference agency) would render the “owned or purchased by” language in 7(b)(2) meaningless. Again, this comment is inconsistent with the plain language of the statute. Under the statute, a resource “owned or purchased” by a preference agency can be included in the resource stack only if BPA forecasts that the resource will be owned or purchased by the preference agency and either: (i) the resource will be acquired from the preference agency by BPA;<sup>3</sup> or (ii) the resource will not be committed to load pursuant to section 5(b).<sup>4</sup> This construction is consistent with the plain language of the statute and does not render any of the language superfluous. This construction gives meaning to the language of both section 7(b)(2)(D)(i) and section 7(b)(2)(D)(ii).

By contrast, the interpretation advanced by public power fails to give meaning to the language of section 7(b)(2)(D)(i). This is because public power (erroneously) interprets section 7(b)(2)(D)(ii) to permit inclusion of power in the resource stack, even if it is sold by a preference agency, so long as it is not committed to preference customer load. Under this (erroneous) interpretation, power acquired by BPA from a preference customer would qualify for inclusion under section 7(b)(2)(D)(ii), rendering section 7(b)(2)(D)(i) meaningless surplusage.

More fundamentally, when Congress intended that resources be included in the resource stack notwithstanding the preference customers’ sale of those resources, it specifically so provided—and did so expressly with respect to resources acquired by *BPA* from the preference customers (section 7(b)(2)(D)(i)). By contrast, Congress did not expressly provide for inclusion in the resource stack of resources purchased from the preference customers by any utility *other than BPA*. Congress knew how to include resources based on the preference customers’ sale of such resources. It did so for the sale of resources to BPA. By including in the resource stack certain sales (to BPA) and not

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<sup>3</sup> 16 U.S.C. § 839e(b)(2)(D)(ii).

<sup>4</sup> 16 U.S.C. § 839e(b)(2)(D)(i).

others (sales to other utilities), Congress intended that resources sold to investor-owned utilities not be included in the resource stack.<sup>5</sup>

**3. Should section 7(b)(2)(E) reserve benefits be limited to reserves provided by Direct Service Industry (DSI) loads?**

**SUPPLEMENTAL RESPONSE:**

On October 22, 2007, in preliminary written responses to a request for feedback from BPA, the investor-owned utilities pointed out that section 7(b)(2)(E) reserve benefits should include the benefits of all reserves, including reserves from BPA's surplus power sales in the wholesale power market and that the NWPA definition of "reserves" does not limit reserves to those from any particular source, but rather includes, for example, rights to withdraw, as provided by specific contract provisions, portions of the electric power supplied to customers.

Oral responses to BPA's request for feedback, and to the investor-owned utilities' written responses, included a comment that questioned whether BPA's surplus power sales were contracts for the purchase of power from BPA pursuant to the NWPA and hence, whether they were contracts for sales to "customers".

BPA makes surplus sales in the wholesale power market under the Northwest Power Act. Such sales are to be made pursuant to section 5(f) of the Northwest Power Act:

[BPA] is authorized to sell, or otherwise dispose of, electric power, including power acquired pursuant to [the Northwest Power Act] and other Acts, that is surplus to [BPA's] obligations . . . .<sup>6</sup>

BPA's testimony in the WP-07 rate proceeding confirms that BPA surplus sales in the wholesale market, such as those under the FPS-07 rate schedule, are made under the Northwest Power Act and constitute reserves (and provide reserve benefits) as contemplated by the Northwest Power Act and its legislative history. BPA adopted the FPS-07 rate in the WP-07 proceeding for its surplus power sales in the wholesale power market:

BPA has sold, and will continue to sell, secondary energy in the real-time, day-ahead, balance-of-month and forward electricity markets. BPA engages in sales (and purchase) transactions with

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<sup>5</sup> Under the statutory construction principle of *expressio unius est exclusio alterius*, explicit enumeration of one item in a class excludes other items of that class that are not listed.

<sup>6</sup> 16 U.S.C. § 839c(f). Thus, NWPA section 5(f) specifically authorizes BPA to make surplus sales.

most of the major participants in the West Coast wholesale energy market. Like other market participants, BPA, in all of the aforementioned transactions, adheres to Western Systems Power Pool (WSPP) contract terms and conditions, which reflect industry standards. The proposed FPS-07 rate will be used in all of the transactions just described.

(WP-07-E-BPA-26, p. 5, ll. 10-16.) BPA described the purpose of the FPS-07 rate schedule as follows:

BPA developed the FPS-07 rate schedule to replace the FPS-96R rate schedule which expires on September 30, 2006. As with the FPS-96R rate schedule, BPA's overall objective of the FPS-07 rate schedule is to provide BPA with a degree of flexibility so that it can effectively market surplus firm energy from the Federal Columbia River Power System (FCRPS) in the West Coast wholesale energy market.

Factors such as weather, time of year, and fish and wildlife constraints cause generation levels available from BPA's hydro-based system to vary widely from year-to-year, month-to-month and even day-to-day. In addition to this wide variation in BPA's surplus energy amounts, BPA must manage variations in load. As a consequence of these competing factors, BPA must routinely participate in the West Coast wholesale market - both selling power when a surplus exists, and buying to make up any shortfalls.

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At least as early as the 1987 Wholesale Power and Transmission Rate Proceeding (WP-87), the Administrator concluded that he had the authority to establish a type of market-based rate. *See*, WP-87-A-02, at 242-251 (discussing the Market Transmission rate, MT-87). Later, in the WP-96 rate case, BPA pointed out that section 7(e) of the Northwest Power Act grants the Administrator considerable rate design discretion, including the ability to employ rate designs that use a market-based approach. *See*, WP-96-A-02, at 457. The Agency further found that section 7(e) and its legislative history make clear that BPA's cost allocation directives concern the amount of revenues to be recovered from customer classes, and not the design of the rates to recover those revenues. *Id.* at 458. Therefore, in the aggregate, BPA's rates must be, and are, designed to recover BPA's total costs.

The proposed FPS-07 rate schedule, like its predecessors the FPS-96 and FPS-96R rate schedules, provides BPA with improved assurance of cost recovery and an enhanced ability to keep rates low. Revenues under the FPS-07 rate schedule are credited against

BPA's revenue requirement and, as such, FPS-07 will serve as one component of BPA's overall rate structure to ensure that, in the aggregate, BPA recovers its overall costs.

(WP-07-E-BPA-26, p. 3, l. 8 through p. 4, l. 23.) Indeed, the foregoing quoted language demonstrates that BPA has concluded that the NWPA authorizes BPA to adopt market based rates "so that it can effectively market surplus firm energy from the Federal Columbia River Power System (FCRPS) in the West Coast wholesale energy market". In short, BPA's sale of surplus power at market based rates is a "result of the Administrator's actions under this chapter [(the NWPA)]."<sup>7</sup>

Reserves include BPA's rights to interrupt, curtail or otherwise withdraw sales of surplus power when necessary. BPA may establish these rights through contractual recall provisions or through power sales for limited terms (*e.g.*, hour ahead, hourly, day ahead, balance of week, balance of month, monthly and seasonal). This ensures that such BPA surplus power sales benefit and do not pose service and cost risks to BPA's firm power load in the region under sections 5(b), 5(c) and 5(d) of the Northwest Power Act.

BPA's "secondary market" or "surplus" power sales in the wholesale power market meet the definition of "reserves" under the Northwest Power Act and fulfill the purposes contemplated for BPA reserves under the Northwest Power Act.

**14. Should the 7(b)(3) allocation of the rate protection amount be modified to include an allocation to surplus sales?**

**SUPPLEMENTAL RESPONSE:**

The Public Power Comments appear to suggest that purchasers of surplus power from BPA do not contract "for the purchase of power from the Administrator pursuant to this chapter [NWPA]."<sup>8</sup> As discussed above, BPA sales of surplus power are made pursuant to the NWPA. Also as discussed above, this is particularly clear with respect to BPA sales of power at market based rates.

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<sup>7</sup> 16 U.S.C. § 839e(b)(2)(E)(ii).

<sup>8</sup> 16 U.S.C. § 839a(7).

## **SUPPLEMENTAL NEW QUESTION**

**16A. Should the high water mark of any utility be decreased to the extent it both purchases power at Tier 1 rates and participates in the REP?**

### **RESPONSE:**

Yes, assuming that the *net requirements* of any utility are not decreased to the extent it both purchases power at Tier 1 rates and participates in the REP, the *rate period* high water mark of such utility should be decreased to the extent it both purchases power at Tier 1 rates and participates in the REP during such rate period.

Although public power entities have a right to participate in the REP if they qualify, the legislative history of the NWPA indicates that this was considered unlikely:

Although all utilities are permitted to enter into such [REP] sales, its benefits are likely to be limited to utilities that are not entitled to service as a preference customer.<sup>9</sup>

In addition, preference utility participation in the REP exposes BPA and its customers to costs that result if preference utilities curtail service from BPA in favor of then-cheaper resources that later turn out to be more expensive than BPA power. Historically, such curtailments of purchases from BPA by preference utilities have been significant:

In 1994, market prices were dropping and conventional wisdom was that power market deregulation was likely to deliver consistently lower wholesale prices. By 1995, many BPA customers were clamoring to reduce their purchases from BPA so they could take advantage of lower prices offered by the burgeoning population of power marketers. The direct-service industries (DSIs) reduced their take from BPA by around 800 aMW in 1995, and public utilities followed in 1996 with over 1,000 aMW of load reductions. At this time, it was taken as a given by many of BPA's customers that they would no longer rely on BPA to meet all their requirements. The question was whether BPA could keep its costs low enough to avoid loss of so much load that a major "stranded cost" problem would result.<sup>10</sup>

Of course, the situation has now reversed, and preference utilities are seeking high water marks (HWMs) that will permit them to buy as much power as they can get from

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<sup>9</sup> H. Report 96-976, Part I (Commerce) at 60.

<sup>10</sup> BPA, "What Led to the Current BPA Financial Crisis? A BPA Report to the Region," at page 3 (Apr. 2003), available at: [http://www.bpa.gov/corporate/docs/2003/Report\\_to\\_region.pdf](http://www.bpa.gov/corporate/docs/2003/Report_to_region.pdf).

BPA at its Tier 1 rate. It would be ironic if the costs these entities incurred while they were away from BPA made them eligible to participate in the REP. Such utilities would benefit from the ability to purchase power at Tier 1 rates *and* participate in the REP based on higher cost resources acquired while they were away from BPA. *Cf.* Residential Exchange Program Settlement Agreement with Clark Public Utilities; Administrator's Record Of Decision, dated Feb. 10, 2006, which states as follows on page 6:

Cowlitz County PUD (Cowlitz) expressed initial misgivings regarding Clark exchanging the costs of its River Road resource, which was developed in order to forego purchases from BPA and, in retrospect, has proven to be a costly decision.

In light of the foregoing, BPA should decrement the rate period high water mark of any utility to the extent it both purchases power at Tier 1 rates and participates in the REP during such rate period.

### **PUBLICS' ADDITIONAL ISSUE #1**

**How should the in lieu provision be structured for purposes of the implementation of section 7(b)(2) and the RPSA?**

### **SUPPLEMENTAL RESPONSE:**

The Public Power Comments suggest that the in lieu provision of section 5(c)(5) of the NWPA may be limited to implementation as "strictly financial transaction, and should be based on the cost of power BPA forecasts being available on the market that it uses in the relevant rate case for all purposes." However, there is no basis in the statute for limiting implementation of the in lieu provision to a "strictly financial transaction." Further, it is not clear that the cost of in lieu power should be based on the cost of power BPA forecasts being available on the market in the relevant rate case.